



## Developing our approach to implementing MiFD II conduct of business and organisational requirements

ICAEW welcomes the opportunity to comment on the paper *DP15/3 Developing our approach to implementing MiFD II conduct of business rules and organisational requirements* published by Financial Conduct Authority on 26 March 2015, a copy of which is available from this [link](#).

This response of 26 May 2015 has been prepared on behalf of ICAEW by the Financial Services Faculty. As a leading centre for thought leadership on financial services, the Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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## GENERAL POINTS

### Outcomes focused regulation

The implementation of MiFD II needs to focus on creating a regulatory environment that helps firms deliver good quality advice and services that meet the disparate needs of UK consumers on affordable basis. We believe a principles-based approach towards developing the conduct of business and organisational requirements will generally deliver the best consumer outcomes. However, clear guidance will also be required so that firms can interpret these principles into standards that are unambiguous and consistent across the sector. The approach should not be overly complicated or disruptive to embedding the RDR, with the objective of helping firms to deliver affordable, professional independent financial advice to a wider section of the population.

### Building on the Retail Distribution Review

The Financial Conduct Authority (FCA) should continue to develop the regulatory framework established under the Retail Distribution Review (RDR) to help consumers have a clearer understanding of the differences between independent and restricted financial advice propositions. This approach will help firms to develop sustainable business models that can meet the particular needs of different consumer segments.

We believe the core concepts that underpin the RDR should be used as the basic building blocks for developing an approach to the implementation of MiFD II and that the existing regulatory terminology developed for the retail investments sector in the UK should generally be retained.

### Independence

The concept of independence revolves around the principle of objectivity. In context of the retail investment sector, ICAEW generally regards the application of the term independence to mean advice that is objective and non-conflicted. This means that a firm must be willing and able to undertake an objective analysis of the main factors that could have a significant effect on the client outcome and provide advice and recommend products on an objective and non-conflicted basis.

The disparate nature of the retail investments sector inevitably means the practical application of the general principle of independence will vary according to individual circumstances. Regulatory terminology therefore needs to be sufficiently broad to enable firms to use their professional expertise to apply the principle of independence to serve the best interests of their client base. The development of a framework for the implementation of MiFD II may also provide the FCA with an opportunity to help firms develop independent advice models that are affordable to a broader range of mass-market retail clients.

## RESPONSES TO SPECIFIC QUESTIONS

We have limited our response to the specific areas where ICAEW is best equipped to provide informed comments, acting in the public interest.

**Q1: Do you agree that, in principle, we should look to ensure a consistent regulatory regime between insurance-based investment and MiFD II based investments? If not, please explain why.**

Yes. For the benefit of consumers a consistent and straightforward regulatory regime is required across all areas and for all firms, including firms that are not UK based. We believe the existing domestic RDR standard is a sensible starting point, and that the FCA's concept of 'substitutability' provides a useful practical reference point for determining whether or not a product should be treated, for regulatory purposes, as a retail investment.

**Q2: Assuming IDD does not replicate MiFD II in terms of changes to suitability assessments and client reporting, we plan to apply minor changes where we currently read-across MiFD**

**II rules to insurance based investments and pensions. Do you agree with this approach? If not please explain why not.**

We believe that this is generally the correct approach.

**Q3: Assuming IDD does not replicate MiFD II in terms of the appropriateness test, should we look to apply MiFD II's appropriateness test to sales of insurance-based investments and pensions?**

Yes

**Q13: Do you consider that MiFD II's standard of independent advice is different, in practice, to the UK's standard? If so, please explain why?**

At a practical level the advice process should operate as a funnelling process, whereby a firm and its advisers take into consideration all the significant factors that need to be evaluated in a client specific context and in respect of the particular market or markets in which that firm operates. To be capable of delivering objective outcomes, the firm needs to be willing and able to consider all issues that are relevant in the circumstances which could have a material significance on the outcome. It is the firm, not individual advisers, that is responsible for delivering advice and firms must therefore organise their affairs and marshal resources to ensure that the independence standard is met.

The terms 'comprehensive and fair' and 'a sufficient range of products from a sufficiently diverse group of providers' both seem to be generally consistent with the concept of independent financial advice. Indeed, the terminology could easily be amended to read 'a comprehensive and objective analysis of a sufficient range of products from a sufficiently diverse group of providers', without the changes affecting the underlying concept of independence.

We do have some concerns that the issue under consideration may have a tendency to become excessively preoccupied with semantics. The focus needs to be directed at the scope and integrity of the advice process and ensuring that any potential conflicts of interest are adequately managed. With this in mind additional guidance on exactly what in practice is meant by the terms 'sufficient', 'comprehensive', 'sufficiently diverse' and 'proportionate' would greatly help address the somewhat circular nature of the issues that need to be resolved at the practical level.

ICAEW believes the concepts of a relevant market and retail investments products (RIP's) developed under the RDR, generally work well. However, customers need a clear, straightforward explanation of the scope of the advice services offered and the types of products and range of product providers that will be taken into consideration. This needs to be communicated in plain English, with a simple explanation of the practical implications that any restrictions may have on their affairs.

**Q14: How should we implement MiFD II's requirement to develop an independent standard for advice on shares, bonds and derivatives?**

We do not believe extending the scope of investments that need to be considered by independent financial advisers to include equities, bonds or derivatives would be in the best interest of consumers as it would limit the supply of good quality advice and add to costs. The existing scope of RIP's covers the needs of the vast majority of retail investors and extending the scope of the independence standard to include equities, bonds or derivatives would therefore be counter-productive. In circumstances where a customer needs advice in this area, referrals could be made to a sector specialist as a permitted third party, which generally represents a more sensible way of addressing the need.

The application of the MiFD II requirement for an independent standard for advice on shares, bonds and derivatives needs to be undertaken on the basis of ensuring any changes do not restrict the supply of affordable professional advice in this area, or which serve to increase complexity or that serve to confuse consumers. The concept of independence as developed within the RDR

probably represents a sensible starting point, subject to on-going consultation and feedback from firms that operate in this specialist area.

**Q15: Should we continue to include insurance-based investments and pension products within our definition of ‘retail investment products’?**

Yes

**Q16: Should we include structured deposits within our definition of ‘retail investment products’?**

No. There are occasions when structured deposits could be appropriate but, in general terms, the majority of retail clients can be well advised without need to include these in the universe of products which need to be considered. Where a firm has more sophisticated clients who could benefit from advice in this specialist area, the firm could provide in-house advice provided that the firm has the expertise to do so. Alternatively, a firm should be able to refer this type of client to an external expert without that course of action comprising its independence status.

**Q17: Do you think we should explore applying MiFD II’s remuneration standards for sales staff and advisers across to non-MiFD II business?**

It is right that all firms within the financial services sector should adhere to the same high level of remuneration principles that seek to purge practices that are detrimental to customers. A two-tier approach does not appear supportable if the integrity and credibility of advice to clients is to be protected. However, firms must be able to retain sufficient flexibility to justify how their own remuneration approach takes account of wider risk and quality considerations, including how they manage the risk of bias.

**Q22: Are there any technical challenges firms are likely to face in meeting these disclosure requirements that you feel we might be able to help address? If so, what solutions do you suggest overcoming these challenges? & Q23: Should we investigate developing a standardised format for disclosing costs and charges for both point-of- sale and post-sale disclosures?**

In principle, it seems preferable to be presented with only one consistent number that represents the overall charge being made within a particular product with some generic, plain English explanation of the type of charges involved in arriving at this number. In practical terms, however, this will not be easy to deliver given the disparate nature of products and nature of services that is available in the retail investments sector.

To deliver aggregated disclosure of all costs and charges in a meaningful format for consumers implies that coordination and consistency across 3 regulatory regimes (MiFD II, PRIIPs, and pensions) will be required. The complexity of charges and costs that can be incurred within difference structures and over different time periods, inevitably presents significant challenges, for example in the area of bid and offer spreads, dealing commissions, stamp duty etc.

Detailed consumer research will therefore be required to understand what needs to be done to create disclosures that are meaningful for the average retail customer. However, firms need to have a degree of flexibility as regards to how information is presented so that the format is best suited to their particular customer base. Simplicity and comprehensibility need to be the key drivers for all regulatory disclosures, particularly given that more information can be counterproductive, leading to confusion, information overload and consumer disengagement.